

What Is a Credit Score?

- ▶ For those who are Massachusetts residents, you are entitled to one free credit report from each of the three credit reporting agencies each year.
- ▶ To learn about how to protect your credit, visit our web site and access our library. Click on the topic "Financial Fraud" and select the article entitled "Protecting Your Credit."

Ever wondered why your application for a credit card was declined? How the interest rates on your loans were determined? Or what those advertisements about getting your free credit report mean? All of these are related to one's credit score.

What is a credit score? It is a system that creditors, like banks, use to determine whether to extend credit to you, the consumer, based on the probability that you will repay the loan and make the payments when they come due. In addition, it is sometimes used to determine the interest rate on the loan. Generally, scores above 720 are considered excellent and you will qualify for most loans. If you have a score in the high 600s to 700s, you will qualify for most loans but not at the best interest rates. Consumers with scores below the mid-600s may not be able to qualify for credit cards loans, and even if they do, would have to pay unattractive rates. So what are the factors that determine your credit score and what steps can you take to improve it?

First, your payment history is the most important component of your credit score. If you have paid bills late or declared bankruptcy, this will lower your score. The best way to keep up with your monthly payments is to live within your means and only use credit cards if necessary. In addition, try to set up an emergency fund to protect you from unexpected expenses or changes in your income, like losing your job.

The second component looks at the amount you owe, or your debt-to-credit ratio. You should have some debt on your accounts to show that you are able to handle credit, but if the amount you owe is close to your credit limit, it is likely to have a negative effect on your score. In addition, some credit card issuers have been reducing lines of credit for customers who have not have any late payments, which will have the effect of increasing your debt-to-credit ratio so make sure to call your issuer to get this reversed if you are affected.

The length of your credit history looks at how long you have had a credit track record and

considers the time since your accounts were opened and they were last used. Thus, even though you might have some inactive accounts, it is important not to close your oldest accounts especially if you have a relatively short credit history of less than 10 years.

Fourth, creditors look at whether you have inquired for new credit lately. Do not apply for too many accounts within a short period because it makes it look to creditors as though you are desperate for credit. If you need to make multiple inquiries for home or car loans, or for credit card applications, do it within a short period of time, between 14 to 30 days, so that it will be treated as a single inquiry. Speak to your financial advisor on the best ways to apply for new credit if you need to.

The last factor used in determining your credit score is the types of credit that you have. Try to have a good mix of different types of credit, including credit cards, car loans, and mortgages, which might take longer to establish depending on your current level of income. However, refrain from applying for too many credit cards because this may have a negative impact on your score.

To learn more about your credit score, go to Annualcreditreport.com and obtain a free annual credit report from any of the three major providers—Experian, TransUnion, or Equifax. You will not get your credit score with this free report but you will obtain qualitative information based on the five factors mentioned above, and learn whether you have any inaccurate information or unauthorized accounts. If you would like a more detailed report with your credit score, you can purchase the report from the providers.